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ZNR UUUUU ZZH
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FM AMEMBASSY TBILISI
TO RUEHC/SECSTATE WASHDC PRIORITY 7378
INFO RUEHZL/EUROPEAN POLITICAL COLLECTIVE PRIORITY
RUEAHL/HOMELAND SECURITY CENTER WASHDC PRIORITY
RUCPDO/DEPT OF COMMERCE WASHDC PRIORITY
RUEATR/DEPT OF TREASURY WASHDC PRIORITY
RUEHLM/MILLENNIUM CHALLENGE CORPORATION PRIORITY

UNCLAS SECTION 01 OF 02 TBILISI 002091

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STATE FOR EUR/CARC AND EB/IFD/OMA
COMMERCE FOR 4231 DANICA STARKS, MOSCOW FOR USDA

E.O. 12958: N/A

TAGS: [ECON](#) [PGOV](#) [GG](#)

SUBJECT: REVENUE SERVICE HEAD POSITIVE ABOUT TAX AND
CUSTOMS REFORMS

REF: A. 06 TBILISI 2698

[1](#)B. TBILISI 01791

[1](#)C. TBILISI 01456

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[1](#)1. Summary. On August 8, Mindia Gadaevi, head of Georgia's Revenue Service, discussed with Econoffs the progress made to date in the reorganized service, which includes customs and tax departments and elements of the former Financial Police. Tax revenues are up by one third year on year in the first quarter of 2007 as the gray economy becomes legalized. The Revenue Service is targeting its tax auditing and customs resources and looking to the Internet as a medium for taxpayer obligations. Gadaevi dismissed predictions that an increase in the personal income tax effective next year will have negative consequences on employees. End Summary.

[1](#)2. On August 8, Econoffs met with Mindia Gadaevi, head of Georgia's Revenue Service to discuss progress made during his first five months in office. He said he sees his role as a strategic manager instead of the head tax or customs investigator. He and his staff have developed a strategy for the Revenue Service, which combines the tax administration and customs, as well as elements of the former Financial Police--following the Estonian model (ref A). Although an IMF expert gave advice on development of the strategy, Gadaevi said, the Revenue Service decided to do almost everything the opposite way. Nevertheless, the IMF reviewed the strategy, he said, and accepted it as a good effort. The Service aims to increase revenues, reduce the shadow economy, prevent corruption, maintain a positive image, and increase customer satisfaction.

Revenue Increases

[1](#)3. Gadaevi said that statistics for the first quarter of 2007 show tax revenues increased by 30-35 percent from the same period last year. Gadaevi attributes the continuing strong growth in tax revenue to a combination of economic growth, more efficient tax administration, tougher enforcement and the legalization of the gray economy as more businesses decide it is better to be on the legal side of the law. The Revenue Service is in the process of closing various informal markets, or bazrobas. The action will cost many people their jobs, but Gadaevi contends the cost to the economy of the illegal and unaccountable commercial activity is greater than

than the social cost of the lost jobs. Business owners are realizing there is a competitive advantage to being compliant, and the tax system is now more or less stabilized, he said. One advantage to compliance, he said, comes in the form of Value-Added Tax (VAT) refunds. Some businesses claim that the Revenue Service is exceedingly slow to refund VAT. Gadaevi said he has met personally with several businesspeople who raised such complaints and discovered that many had never even applied for their refunds in the first place. The Revenue Service is launching an advertising campaign to urge businesses to apply for their VAT refunds and promising a one-month turnaround for straightforward cases.

Targeted use of Resources

¶4. Gadaevi said that the current pace of reform in both the tax and customs departments cannot continue because almost all necessary improvements are in place. He joked that there will be no job for him next year. Now the Service will focus on risk management to more effectively target its resources, he said. In the Tax Department, 350 auditors will target companies where the risk of not paying is high. According to Gadaevi, 640 large companies produce 70 percent of state tax receipts. At the same time, the Customs Department is developing a Gold List of high-volume, thoroughly vetted businesses which can submit customs clearance documents electronically. Gadaevi said the Revenue Service has not been involved at all with developing the Poti Free Trade Zone (ref B), but he expects the zone will create new jobs. Gadaevi expects taxpayers will be able to perform more and more of their obligations via the Internet in the future.

Merger of Income and Social Security Taxes

¶5. Gadaevi was confident that after the recently enacted elimination of the social tax and increase of the personal

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income tax from 12 to 25 percent takes effect in January 2008 (ref C), employers will increase wages to compensate their employees, despite widespread concern to the contrary. He predicted that when the state raises gross salaries by 20 percent, as it intends to do after the social tax is abolished, all large businesses will raise salaries accordingly. Businesses that fail to follow will lose their competitive advantage and have internal problems with their employees, he claimed. Since the combined taxes will be withheld from employee's paychecks, employees would immediately feel the pinch if their net wages are not increased. Thus, an employer's failure to increase wages would not escape his employees' notice. Gadaevi said there will be no benefit gained for businesses who do not increase the net salaries.

Comment

¶6. Comment: AmCham officials confirmed that large employers, especially American ones, are planning to keep their bottom line the same, which actually will result in a net increase of 2.7 percent for the employee. AmCham officials could not confirm, however, that all small and medium-sized enterprises, especially in the regions where unemployment is higher, will follow the larger companies' lead. Elguja Meladze, President of the Georgian Employers' Association, told Econoff that the majority, 60-65 percent, of employers will increase employees' gross salaries. We will continue to urge our contacts within the private sector to keep their bottom-line operating costs the same and not let the employees take the tax hit. End Comment.
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